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WHAT DO CANADIANS LOOK FOR IN MAKING REAL ESTATE INVESTMENTS IN KOREA?

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June 1998

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What do Canadians look for in making Real Estate investments in Korea?

For Canadians, the decision to invest in Korean real estate is no different from any other investment decision. The basic criterion is this: does the potential return justify the risk? In order for Canadian investors to put substantial sums of money into Korea, they need to be convinced that this is their best available option.

Real estate differs significantly from all other investment vehicles, from stocks to bullion. Land has inherent value, since it is indestructible and in limited supply, especially in populated areas. Historically, the value of real estate has always been less volatile than most other investments, and consequently it has a reasonably predictable income flow. For these reasons real estate has a place in most well balanced investment portfolios of any size, and has long been recognized as an excellent method of diversifying a traditional portfolio of equities and bonds.

Recent and ongoing economic crises, particularly those in Asian countries, have been characterized by dramatic swings in the value of national currencies, stocks, bonds and many other investment vehicles. The speed of modern communications technology, which permits capital transfers within seconds, has undoubtedly increased the potential for such volatility, and has made today's money manager class far less patient and more nervous than ever before. The Asian crises have therefore seen investors driven in large numbers towards 'safe havens' and fixed income securities. In such a climate, real estate can represent an excellent investment, because its value is cyclical by nature. The current economic climate in Korea has clearly caused a drop in economic activity and land prices, but the question for potential Canadian investors must be this: is Korean real estate a bargain at this time?

Recent government activity to relax regulations on foreign land ownership and development is clearly a necessary first step in attracting investment capital to Korea. The Korean Research Institute for Human Settlements (KRIHS) has pointed out that land holdings by foreigners in Korea currently stand at just 0.04%, wheras this amount is ten times higher in Finland, and twenty five times higher in Switzerland.

Most Canadians would agree that any overseas investment has an inherently higher risk than an investment made in their own country. Clearly these investors are seeking higher returns, but what conditions do they look for in selecting a good project?

In assessing an overseas investment, Canadians will first take a long, hard look at the country in which they are placing their money. They will want to see political stability, first and foremost, with no hint of future social disruption. They will also be looking for a government climate which encourages them to be there, through policies and incentives which accomodate their needs and reduce their risks. Although real estate is not a highly liquid form of investment, foreigners will need to be assured that there are no state restrictions on the flow of capital and hard currency out of the country. Tax incentives are obviously important here, as well as the lifting of laws restricting the size and type of permissible real estate investment by foreigners.

The 'post-IMF' reforms which have been initiated by the Korean government and by many Korean corporations are clearly designed to enhance competitiveness and to increase efficiency throughout the Korean economy under 'free market' principles. These measures will certainly go a long way in removing barriers to overseas investment, since they will allow foreign companies to compete on equal terms within many previously-closed sectors of the Korean economy. The Korean government has also made it clear that it wishes to encourage long-term joint partnerships between domestic and foreign companies.

All of these efforts will bring Korea more into line with the business practices and social values found in other leading industrial nations. This in turn will improve the viability of the country as a place of choice for international investors. However, a stable political system and a helpful government climate are not enough on their own to attract investment in long-term sectors such as real estate. Canadian investors, like any others, will be looking at the potential in the Korean economy for sustained growth.

Opinions vary as to the reasons for Korea's spectacular growth over the last thirty years, during which the economy grew at an average annual rate of seven or eight percent. Nevertheless much of this remarkable performance can surely be attributed to a well-educated and hard-working labour force, combined with strong government leadership in export development, and the dynamic entrepreneurship of many businesses. If these qualities and attributes are in place following the restructuring of the Korean economy, with its new emphasis on market discipline, transparency, accountability and competitiveness, and with many restrictions lifted, then Korean real estate may begin to appear very attractive to foreign capital. But investors will need to be convinced that structural problems in the Korean economy have been solved, and that a typical five-to-fifteen year investment, as real estate usually is, will yield a good return. For example, when interest rates were around 20% in Canada, real estate yields were 12%, and while there are no specific rules, real estate will likely only be purchased and sold on a comparable overall risk and return basis.

If a Canadian investor can be convinced that Korea's economy is back on a sound footing, and that the long term growth potential is good, then that investor can review a specific project according to certain well-established criteria. It is worth taking a closer look at this decision process, and at these criteria in particular.

Any Canadian real estate professional will agree that **location** is of prime importance. A well located project means that the area is currently highly desirable, and will continue to be so into the future. Investors must also determine whether a project is suitable in a given location, and whether it will maximise the benefits of that piece of property. Location is also important in terms of timing, and successful projects will often require adequate market research.

The **price** of a real estate investment is obviously of great importance to the successful outcome of a project, and yet real estate value is difficult to assess because it is the product of many factors, most of which are constantly changing. Supply and demand have a significant impact on price, and during the life of a project both over-supply and under-supply conditions may be experienced. The purchase price of syndicated real estate should incorporate not only the actual

price but also other values such as guarantees, since this type of investment is structured on a trouble-free basis. Here it is customary for the developer to make certain guarantees, such as cash flow or occupancy guarantees, and the potential benefits of each of these must be given a value.

The **level of risk** that an investor is willing to undertake is often the deciding factor in real estate decisions. If the investor is working with or simply backing a developer, then that developer's track record should be scrutinized to assess past performance. Of particular importance will be the developer's credit history and reputation within the market, information which may need to be acquired on behalf of foreign investors by reputable credit agencies. If the developer has sound financial backing or a good track record, then strong financial statements should also be required by potential investors, since a successful project depends upon a financially successful developer. Real estate is normally a long-term investment, so financial backers must generally accept that such assets may be difficult to sell before the agreed term. Risk refers to the amount of money an individual is personally liable for, so the greater the risk then the greater the return which should be demanded by an investor.

The potential **return on investment** is, of course, the sole motivation for financial backers. Here, tax breaks and incentives may be incorporated into the picture, so all returns should be compared on an after-tax basis. Developers' forecasts should be closely examined by any potential investor to see if they are rational and reasonable, especially in the following key areas: vacancy allowances, total expenses to revenues, mortgage rates, annual projected increases in rental income, and expenses/proceeds of 'upward refinancing'. While the ownership of real estate normally provides certain tax benefits, Canadian investment professionals advise that the investment as a whole must be sound, and that only secondary emphasis should be placed on tax considerations. In general, real estate has long been recognised as an excellent hedge against inflation, and it also performs positively in times of economic growth.

Since every piece of real estate is unique, and there is no central marketplace, **personal considerations** will also be taken into account by prospective investors. These include investment objectives, annual cash requirements and personal risk tolerance.

There are many other investment criteria which may be relevant to a real estate purchase, and which would be used by an interested party to assess its desirability. These include the age and condition of any existing building, the risk and time associated with new construction, the potential of a site for development or renovation, the tenant mix, the creditworthiness of tenants, the terms and conditions of leases, the market conditions and the financing available.

In addition to looking at specific investment criteria, it is also useful to consider the different real estate categories, and to look more closely at the special characteristics of each. For **offices, commercial and industrial buildings**, which include retail and service establishments, Canadian investors would be familiar with tenant leases of between three and five years, usually with renewals at current market rates for additional terms. In Canada, for most non-residential buildings, the tenant is generally responsible for all operating, management and maintenance costs. Under this arrangement, known as net leasing, the profit potential of the investment in the

building is generally unaffected by inflation and other market forces. Of particular importance to the success of these types of investments are: the compatibility of tenants in the building and in the commercial area, ease of access, availability of parking, street visibility of the property, closeness to public transportation and other transportation service facilities and the general economic growth of the community.

For **hotel and motel** investment, other important considerations would be:

etc.

Also: **Shopping Centres**
Residential

Further comments on the specific criteria used by EDC to assess credit worthiness of overseas countries and corporations ....

...'May also want a few words about Canadian investment vehicles such as REITs which raise money from the public through the issue of equity shares and securities, and invest the proceeds in mortgages, construction loans etc.

Concluding remarks